JOINT APPLICATION OF

GROUNDHOG MTN. PROPERTY OWNERS, INC.

and **CASE NO. PUE990814**

GROUNDHOG MTN. WATER & SEWER COMPANY, INC.

For authority to acquire and to dispose of utility assets pursuant to the Transfers Act and for certificates of public convenience and necessity pursuant to Va. Code §§ 56-265.2 and 56-265.3

REPORT OF MICHAEL D. THOMAS, HEARING EXAMINER

January 9, 2002

HISTORY OF THE CASE

On December 12, 2000, Groundhog Mtn. Property Owners, Inc. ("GMPO") and Groundhog Mtn. Water & Sewer Company, Inc. ("GMW&S" or the "Company") (collectively, the "Applicants") completed their Application which was initially filed on December 13, 1999, and subsequently amended on March 14, 2000. In their Application, GMPO and GMW&S request authority pursuant to the Transfers Act, Chapter 5 of Title 56 of the Code of Virginia, for GMW&S to acquire and for GMPO to dispose of its water and sewer facility assets pursuant to a license agreement between the parties. Pursuant to that license agreement, GMW&S will have the sole right to occupy and to use all of GMPO's water and sewer assets to provide water and sewer service to the residents of Groundhog Mountain, Doe Run, Buck Hollar, and Groundhog Hills subdivisions located in Patrick and Carroll Counties, Virginia (the "Subdivisions"). In addition, the Applicants request, pursuant to Va. Code §§ 56-265.2 and 56-265.3, certificates of public convenience and necessity for GMW&S to acquire the above-referenced assets and to provide water and sewer service to the residents of the Subdivisions. Finally, the Applicants request approval of GMW&S's proposed rates, rules, and regulations of service.

GMW&S proposed the following rates:

Water Rates

1. Each member of GMPO who is a water customer shall pay an assessment (described below) for the operation and maintenance costs of the water system

and any special assessment for any required capital improvements to the water system.

2. In addition to annual assessments for operation and maintenance of the water system, GMW&S may, from time to time, levy special assessments for one year only for the purpose of defraying, in whole or in part, the cost of any construction, repair, replacement, or expansion of the water system, including the necessary fixtures and real property related thereto.
3. All annual and special assessments for the water system shall be fixed at a uniform rate for all customers.
4. For fiscal year 2001 (January 1 – December 31), the annual assessment for the water system is established at $140.25 per quarter, or $561.00 annually.

Sewer Rates

1. Each member of GMPO who is a sewer customer shall pay an assessment (described below) for the operation and maintenance costs of the sewer system and any special assessment for any required capital improvements to the sewer system.
2. In addition to annual assessments for operation and maintenance of the sewer system, GMW&S may, from time to time, levy special assessments for one year only for the purpose of defraying, in whole or in part, the cost of any construction, repair, replacement, or expansion of the sewer system, including the necessary fixtures and real property related thereto.
3. All annual and special assessments for the sewer system shall be fixed at a uniform rate for all customers. For fiscal year 2001 (January 1 – December 31), the annual assessment for the sewer system is established at $110.50 per quarter, or $442.00 annually.

Bills for water and/or sewer service shall be rendered quarterly in advance. At the option of the customer, water and sewer assessments may be paid annually.

GMW&S proposes a late payment charge of 1½ percent per month for bills not timely paid; a customer deposit equal to a customer's estimated liability for two months' usage; and a $6.00 bad check charge. GMW&S also proposes a $35.00 charge to terminate water and/or sewer service for nonpayment of any utility bill, for violation of the Company's rules and regulations of service, or for termination of water service at the customer's request. GMW&S further proposes a $45.00 charge to restore water service if such service has been discontinued for violation of the Company's rules and regulations of service or for nonpayment of any bill. The $45.00 charge would apply when it is necessary to reconnect water that was turned off in connection with termination of sewer service.

In the event GMW&S installs meters, the Company proposes a $35.00 fee to test a meter unless the meter is found to have an average error rate greater than two percent. GMW&S also proposes to charge $35.00 to remove any meter at the customer's premises.

On January 9, 2001, the Commission issued an Order docketing the case, directing the publication of notice of the Application, and providing interested persons an opportunity to comment on the Application and request a hearing.

On March 19, 2001, Doe Run Properties, LLC ("DRP") and The Doe Run at Groundhog Mountain, Inc. ("DRAGM") (collectively, the "Protestants") filed comments, objections and requests for a hearing. DRP is a customer and owner of utility assets being used by the Applicants. DRAGM is a tenant of DRP and is the operator of The Doe Run Lodge (the "Lodge"). DRAGM is also a customer and a co-operator of the utilities.

In their filing, the Protestants raised a number of objections to the Application. These included: (1) lack of statutory notice; (2) legality of severance of water utility services; (3) legality of vote by GMPO to separate utility services; (4) omission of vital information in the Application; (5) lack of disclosure of use of non-owned utility assets; (6) failure to provide for rental payments for use of non-owned utility assets; (7) improper representation of ownership of utility assets; (8) failure to obtain a certificate of public convenience and necessity ("CPCN") and failure to provide for a financial reserve for possible legal exposure resulting from such failure; (9) failure to provide for a decrease in revenue for customers likely to leave the system; (10) failure to disclose the amount of future assessments, or against whom the assessments will be made; (11) failure to disclose the number and amount of assessments that have not been paid, or paid under protest; (12) failure to disclose the status of existing environmental or other permits; (13) failure to adequately delineate the service territory; (14) failure to provide non-owned utility asset rental information in the utility's budget and tariff; (15) failure to adequately disclose the cost of separating the utility systems; (16) failure to address the replacement of water storage tanks currently owned by DRP; (17) excessive cost to install water meters; (18) criteria for membership on the GMW&S board; (19) requirement for independent review of Applicants' actions; and (20) rebuttal comments on the failure of unification of the utility systems.

On April 2, 2001, the Applicants filed a Response to Comments, Objections and Requests for Hearing of Protestants, which addressed each of the objections raised by Protestants. Their response is summarized below:

1. The Applicants provided notice in accordance with the Commission's January 9, 2001, order, a copy of which was mailed to all water and sewer customers including Protestants.
2. The Applicants do not propose using DRP's sewer assets to operate their sewer system. The Applicants included both sewer systems in their service territory; however, the Applicants desire to operate the GMPO water system independently from DRP's water system.
3. The Applicants deny there was any irregularity regarding the vote to separate the water systems. The Applicants argue the matter is not relevant to these proceedings.
4. The Applicants provided all the information requested by the Commission's Staff. The Applicants further represent that they currently have two wells, Well 1 (Buck Hollar) and Well 3 (Batson Cove, which is inactive). The Applicants are in the process of bringing a new well online, the Dogwood

Well. With two active wells, the Applicants believe they can meet their existing residential demand. Connections to the system would be governed by the rules and regulations approved by the Commission. The rates included in GMW&S's tariff will allow the utility to pay all its lawful obligations. The Applicants believe the volume discount sought by Protestants is fundamentally at odds with sound water conservation measures.

5. The Applicants believe the only parties objecting to separating the two water systems are the Protestants. The Commission has received no other complaints.
6. The Applicants deny any non-contractual obligations to Protestants. They do not intend to rent or lease any utility assets from DRP.
7. The Applicants have legal title to all water and sewer assets required to operate GMW&S.
8. The Applicants deny any legal liability for failing to obtain a CPCN and, if there were such liability, Protestants, as co-providers of utility services for more than 20 years, would have joint and several liability.
9. The Applicants propose no change in the service area for the two sewer systems. Consequently, there should be no change in sewer revenues. The Applicants are proposing to discontinue water service to the Lodge commercial complex, which consists of the restaurant, pool chalets, laundry, and swimming pool. The Applicants contend the commercial complex has received free water from GMPO for more than 20 years; consequently, there will be no loss in revenue to GMW&S.
10. The Applicants state that it is impossible to determine the amount of future assessments for operating and capital needs. The Applicants represent that all future assessments would be uniform, nondiscriminatory, reasonable and just.
11. The Applicants represent that Protestants have unpaid assessments of $47,500.00. The Applicants state they do not intend to rely on unpaid assessments as a source of revenue, but they reserved the right to use legal means to collect such assessments.
12. The Applicants admit that the Virginia Department of Health, Water Works Operation Permit, which states "Buck Hollar and Doe Run Lodge," was not issued in the legal name of any of the parties. The Applicants intend to correct this oversight after the Commission issues the CPCN.
13. GMW&S's service territory includes Carroll County because the actual boundary between Patrick and Carroll Counties in the area is uncertain. The Applicants obtained approval from the Carroll County Board of Supervisors to certificate the utilities.
14. The Applicants state the Application relies on the best data available and includes no unknown or speculative information.
15. There are no additional costs associated with the sewer system. GMW&S's tariff takes into consideration the cost of drilling a new well, installing a new water tank, and adding/replacing water lines.
16. The Applicants may place the new 25,000 gallon water storage tank at any one of three locations, the Buck Hollar Well lot, the Batson Cove Well lot, or the Dogwood Well lot.

17. For a number of reasons, the Applicants are considering installing water meters in the future, the cost of which is addressed by the filed tariff.
18. The Applicants noted that Title 56 of the Code of Virginia does not provide for Commission review of the makeup of public utility boards of directors.
19. The Applicants believe the Commission Staff can adequately review the Application in this case.
20. The Applicants and Protestants have their own reasons why the effort to unify the water systems failed.

The Protestants were the only parties to file objections to the Application and request a hearing. On April 11, 2001, the Commission entered an Order for Notice and Hearing in which it appointed a Hearing Examiner to hear the case, scheduled a public hearing for July 17, 2001, established a procedural schedule for prefiling testimony and exhibits, and required the Applicants to provide notice of the public hearing.

On April 16, 2001, the Applicants moved that the evidentiary hearing be conducted in the City of Roanoke, Virginia. In support of the request, the Applicants stated that the complexity and protracted nature of the application process had overwhelmed them, and they failed to budget for the unexpected costs of legal fees, expert witnesses, and travel costs. The Applicants further stated they have plans for needed capital improvements to the water and sewer systems, and have limited financial resources with which to accomplish the improvements. The Applicants argued that a public hearing in Richmond would impose a financial hardship on the Applicants, and they requested that the hearing be conducted in available public facilities in the City of Roanoke.

By Hearing Examiner's Ruling entered on April 18, 2001, the Applicants' request was granted and the hearing site was moved to the Roanoke City Council Chamber. The Applicants were directed to modify the notice set forth in the Commission's Order for Notice and Hearing to reflect the change in the location for the public hearing.

On May 1, 2001, the Protestants filed a Motion for Reconsideration of the ruling granting the Applicants' motion to change the location of the public hearing. In support of their motion, the Protestants argued that the change in the hearing location would impose financial hardship, add unnecessary costs, and inconvenience the Protestants, potential witnesses of the Protestants, its counsel, as well as the Commission. The Protestants believe the Application is fatally defective, and they contended they would incur significantly less expenses defending their rights if the hearing were held in Richmond.

On May 4, 2001, the Applicants filed their response to the Protestants' Motion for Reconsideration. The Applicants stated that GMPO is a nonprofit property owners association that has one part-time employee; GMW&S is a newly formed corporation that has no cash assets, no income, and no employees. The Protestants, on the other hand, are the owners and operators of the Lodge, the commercial complex located on Groundhog Mountain. The Protestants were the only parties to request a hearing on the Application. The Applicants argued that, between the parties, the Protestants were better able to bear the cost of attending the hearing in Roanoke, than the Applicants were in having to put on a hearing in Richmond. The Applicants further argued the utilities' customers were more likely to attend a hearing in Roanoke than Richmond.

By Ruling entered on May 8, 2001, the Hearing Examiner affirmed his previous decision to change the location of the public hearing from Richmond to Roanoke.

On May 31, 2001, the Protestants filed a Motion for Extension, requesting that the June 5, 2001, deadline for filing their (i) Protest; (ii) Interrogatories to each of the Applicants; and (iii) Requests for Production be extended from June 5, 2001 to June 15, 2001. In support of the Motion, the Protestants stated they needed additional time due to the complexity of the Application and numerous supplements, corrections, and clarifications thereto.

The Applicants were opposed to any extension that would shorten the period of time for them to file their rebuttal testimony.

By Ruling entered on June 4, 2001, the Protestants' Motion for Extension was granted, and a revised schedule for filing testimony and exhibits was established.

On July 17, 2001, the public hearing was convened as scheduled. Wilburn C. Dibling, Jr., Esquire, appeared as counsel for the Applicants. Lisa S. Goodwin, Esquire, appeared as counsel for the Protestants. Marta B. Curtis, Esquire, appeared as counsel for the Commission's Divisions of Energy Regulation and Public Utility Accounting (the "Staff"). One public witness testified at the hearing. At the conclusion of the hearing, counsel for the parties were directed to file a case issues outline identifying for the Commission all of the issues that need to be addressed in this case.[1] The parties were further provided an opportunity to file post-hearing briefs. The Applicants, Protestants and Staff filed post-hearing briefs. A copy of the transcript is being filed with this Report.

SUMMARY OF THE EVIDENCE

Public Witness

Mr. Robert E. Reed has been a part-time resident of the Groundhog Hills subdivision for six years. During that time, he has been pleased with his water service. His concern, and that of some of the other property owners, is that the present water system cannot accommodate any future expansion of the Lodge commercial complex. He believes the two water systems need to be separated to accommodate expansion of the commercial complex. (Tr. at 5-6).

[1]On August 3, 2001, on behalf of all of the parties, counsel for the Staff filed a Case Issues outline herein. Subsequently, the Staff noted that the Case Issues filing failed to identify all of the issues that need to be considered by the Commission. At the direction of the Hearing Examiner, the Staff prepared an outline ("revised Case Issues outline") incorporating all of the issues in the case for the Examiner's use, a copy of which was provided by counsel for the Staff to counsel for the Applicants and Protestants. Counsel for the Protestants objected to the use of the revised Case Issues outline and noted her objection by letter dated August 14, 2001. By letter dated August 20, 2001, the Hearing Examiner again explained to all counsel the necessity for the Commission to address every issue in a legislative case, even those issues in which the parties are in agreement. Although the parties may agree on an issue, the Commission may or may not agree with the parties. Counsel for the parties were provided an opportunity to amend or correct their deficient Case Issues filing, which they declined.

Testimony and Evidence

The Applicants offered the testimony of two witnesses: George B. Viele, president, GMW&S; and Gary Stiffler, president, GMPO.

In his prefiled direct testimony, Mr. Viele provided an overview of the involvement of GMPO with the water system and the sewer systems that are the subject of this case, the acquisition of the water and sewer system assets by GMW&S, and the ability of GMW&S to provide safe and reliable sewer service to its customers at reasonable rates. (Ex. GV-3, at 2).

The development of Groundhog Mountain began in 1971. The original developer, Groundhog Mountain Corporation, installed the water and sewer systems for the entire development. Groundhog Mountain Corporation went bankrupt in 1976. In 1976, Hogwild Estates, Inc., a New York corporation, acquired some or all of the assets of Groundhog Mountain Corporation by foreclosure sale. In 1981, Hogwild Estates conveyed to GMPO its water and sewer systems, related easements for repair and maintenance of the water and sewer systems, and certain roads. Since 1981, GMPO has owned and operated the water and sewer systems for the benefit of homeowners who live in the following subdivisions on Groundhog Mountain: Groundhog Mountain, Doe Run, Buck Hollar, and Groundhog Hills. During this period, GMPO has acquired two additional well lots by deed. (Ex. GV-3, at 1-3).

GMPO intends to transfer, by license agreement, to GMW&S the sole right to occupy and use all of GMPO's water and sewer assets, including all real and personal property currently being used by GMPO to provide water and sewer service. Additionally, GMPO will transfer all of its cash assets derived from water and/or sewer operations. The transfer will occur after the Commission issues a CPCN to GMW&S. (Ex. GV-3, at 2-3).

GMW&S will serve the same sewer customers (71) currently being served by GMPO. The Applicants want to narrowly define their sewer service area to the same area currently being served by GMPO because of the high cost of extending sewer lines in a mountainous area. The Applicants do not want to include DRP's sewer system within their service territory. Each system would be operated independently and would continue to serve its current customers. The Applicants' sewage treatment system consists of laterals and mains that transport the sewage to a 26,000-gallon per day sewage treatment plant. The sewage treatment plant has a current operating permit issued by the Virginia Department of Environmental Quality ("DEQ"). The sewage treatment plant discharges into an unknown tributary of Bird's Branch. (Ex. GV-3, at 3).

GMPO has two wells, the Buck Hollar Well which produces at the rate of 17-18 gallons per minute and the Batson Cove Well which is currently inactive but if placed back in service could yield three to four gallons per minute. The well lots and associated facilities would be transferred to GMW&S. GMW&S recently acquired a new well lot and installed the Dogwood Well. The 48-hour drawdown test on this well indicates that it will safely produce four gallons of water per minute. (Tr. at 34; Ex. GV-3, at 4; Ex. GV-4, at 2).

GMPO's and DRP's water systems are interconnected. The original developer built one system to serve both the commercial complex and the residential subdivisions. As a result of the

developer's bankruptcy, the residential portion of the system was deeded over to GMPO and the commercial property and its water system were sold to DRP.[2] Mr. Viele stated that for more than 20 years by unwritten agreement, the Applicants have relied on the Protestants for water storage capacity, and the Protestants have relied on the Applicants for additional water capacity. (*Id.*).

The waterworks permit issued by the Virginia Department of Health ("VDH") authorizes 134 equivalent residential connections to the water system. At present, there are 112 residential water customers who live in 54 single-family residences, 24 Deer Run Villa Condominiums, and 34 tennis chalet condominiums. The Protestants, including related parties, own 18 of the tennis chalet condominium units. Other individuals own the remaining units. Currently, the Protestants have the equivalent of 20 residential connections to the GMPO water system to serve the Lodge. In Mr. Viele's opinion, the Protestants have enjoyed free water through these connections for than 20 years. (Exs. GV-3, at 4; GV-4, at 1-2).

GMPO's membership voted to separate the residential water system from the Lodge's water system and operate its system for the benefit of the residential customers. The Lodge would be served by its own water system. Mr. Viele believes the interests of the residential customers and the Lodge commercial complex are fundamentally incompatible. Mr. Viele stated the Applicants cannot in the future rely upon the Protestants for water storage capacity. He further stated the Protestants have refused to recognize the rights of the Applicants to store water in the Protestants' tanks, and have refused to allow the Applicants to inspect the Protestants' water storage tanks to assess their safety, reliability, and sanitary condition. Additionally, the rate structure of GMW&S may require higher rates for higher volume users in order to create a disincentive to waste water. This runs counter to the Protestants' position that there should be a discount for higher volume users. With limited water resources on Groundhog Mountain, the Applicants believe in promoting water conservation. To meet this goal, the Applicants may install water meters at some point in the future. Metered rates would encourage water conservation, provide a more equitable rate structure, and assist in the identification of leaks in the system. (Ex. GV-3, at 5-6).

Mr. Viele believes the commercial complex would not support needed improvements to the residential water system. He stated the Protestants refused to pay recent water assessments because there was no benefit to the Lodge. Mr. Viele believes the Lodge's new well, which the Protestants have represented has a yield of 28 - 30 gallons per minute, has sufficient capacity that the Protestants no longer need the Applicants' water capacity. (Ex. GV-3, at 6).

Mr. Viele believes GMW&S can provide sufficient water to meet the demand of current and future residential customers. There are approximately 30 undeveloped lots in the subdivisions and they are of poor quality for building. Any requests to extend service would be considered in accordance with GMW&S's tariff. With the addition of the new Dogwood Well, GMW&S should be able to produce 20,400 gallons of water per day, which exceeds the system's peak demand even if the commercial complex's demand were included. Over the years, GMPO has been making improvements to the water system, such as adding corrosion control and chlorination treatment

[2]Mr. Viele explained that The Doe Run Lodge commercial complex includes a restaurant open for most of the year, ten pool chalets available for rental, laundry facilities, a 55,000-gallon swimming pool, and a small conference center. The Protestants have one well adjacent to the Lodge, which has a capacity of three to four gallons per minute, a 55,000-gallon steel water storage tank, and a 5,000-gallon hydro-pneumatic tank. (Ex. GV-3, at 4).

equipment to each of the wells. In addition, GMW&S developed a three-phase plan to address storage capacity and continual leaks in the system. GMW&S retained a consulting engineer, Adams-Heath Engineering, Inc., to develop the plans for making improvements to the water system. Phase I provides for the installation of the Dogwood Well and associated facilities, and the installation of a 30,000-gallon water storage tank. Phase II provides for the replacement of the water distribution lines in the Groundhog Hills subdivision. Phase III provides for the replacement of the water distribution lines in the other subdivisions. GMW&S expected to complete Phase I by September 2001. The plans for Phases II and III have been approved by VDH and Phase II is expected to be completed during 2002. The completion of Phases II and III is dependent upon adequate funding through loans, grants, or rate structure. (Tr. at 33; Ex. GV-3, at 6-9; Ex. GV-4, at 2-3).

In the past, GMPO contracted with DRAGM to operate and maintain its water and sewer facilities. Assuming it can negotiate a fair contract, GMW&S may continue the contract with DRAGM to perform this service. If GMW&S is unable to reach an agreement, it will contract with one of the other qualified water and sewer operators in the area. (Ex. GV-3, at 9).

In his prefiled rebuttal testimony, Mr. Viele agreed that the rates proposed by the Staff ($128.00 per quarter water rate and $95.00 per quarter sewer rate) appeared reasonable. The Applicants segregated the accounts of GMPO and GMW&S on January 1, 2000. At the present time, they do not have a good picture of the water and sewer utility's actual costs. GMW&S intends to provide the highest level of service possible within the recommended rate schedule. One advantage for GMW&S is that it intends to operate without a profit. (Ex. GV-4, at 6).

Mr. Viele further agreed with the Staff's recommendations to: (1) remove any references in GMW&S's tariff to charges for water meter testing and removal, since the Company has no current plans to install water meters; (2) substitute Statement I attached to Mr. Tufaro's testimony for the language included in the water and sewer rate schedules of GMW&S's tariff; and (3) delete Rule 10, Availability Fees, from GMW&S's tariff, since the Company does not intend to charge an availability fee. (Ex. GV-4, at 6-7).

On cross-examination, Mr. Viele testified the majority of the leaks in the water system have been occurring along Groundhog Hills Road. Since the repairs have been made, there have been fewer leaks in recent years. (Tr. at 49-53).

Mr. Gary Stiffler testified that, assuming Commission approval under the Transfers Act, GMPO would transfer all water and sewer assets to GMW&S. This would include all real property and all personal property, tangible and intangible. Specifically included are any cash assets of GMPO that were derived from water and sewer operations. The transfer would be accomplished by a license agreement that grants GMW&S the sole right to occupy and use all of GMPO's water and sewer assets for a term of 25 years for nominal consideration. A license agreement was used to transfer the water and sewer assets because under GMPO's Articles of Incorporation in effect at the time of the filing of the Application, a sale or lease of the water or sewer system required a two-thirds vote of the entire membership. In such a resort community, it would have been virtually impossible to have a meeting attended by two-thirds of GMPO's membership. Instead, GMPO's Board of Directors authorized the transfer of the assets by license agreement. (Ex. GS-6, at 2-3).

Mr. Stiffler testified the owners of the condominium units in Deer Run Villas and the Tennis Chalets are members of GMPO and participate in the association. As the owner of 18 of the 34 Tennis Chalets, the Protestants hold membership in GMPO. In addition, the general manager of the Lodge serves as an *ex officio* member of the Board of Directors of GMPO. The condominium owners are represented on GMW&S's Board of Directors. (Ex. GS-7, at 1-2)

Mr. Stiffler believes GMPO and GMW&S have moved the Application along in a businesslike and professional way throughout this entire process. During the Application process it became apparent that GMPO could not obtain a certificate as a public service company because it is a non-stock corporation. Consequently, GMPO had to create GMW&S as the entity to hold the certificate. GMPO owns GMW&S's sole share of stock. Mr. Stiffler is confident that GMW&S will be able to provide safe and reliable water and sewer service to GMPO's membership at a reasonable cost. Mr. Stiffler believes the GMW&S's Board of Directors has the ability to manage the operations of the utility and he fully supports Mr. Viele's testimony. (Ex. GS-6, at 3; Ex. GS-7, at 2-4).

If the Commission grants GMW&S a CPCN, the utility's water customers would see the immediate benefit of a new water tank and 2,200 feet of new 6-inch water line. The new water line will dramatically reduce water leaks, reduce maintenance costs, and conserve a resource that is in short supply on Groundhog Mountain. (Ex. GS-7, at 3).

On cross-examination, Mr. Stiffler testified that in the long run the elimination of the 20 free connections to the Lodge would benefit GMW&S. By freeing up those connections, the Company could provide those connections to revenue producing customers. At present, the Company has two pending requests to extend water service, and the additional connections may encourage building on the undeveloped lots in the subdivisions. (Tr. at 65-68).

The Staff offered the testimony of three witnesses: Marc A. Tufaro, assistant utilities analyst; Ashley W. Armistead, Jr., principal public utility accountant; and Robert C. Dalton, principal public utility accountant.

In his prefiled direct testimony, Mr. Tufaro stated the water system is permitted by VDH to serve 134 equivalent residential connections ("ERCs").[3] It is currently serving 132 ERCs. The Applicants are proposing to: (1) discontinue service to the Lodge and its ten pool chalets, which account for 20 ERCs; (2) discontinue using the Protestants' 55,000-gallon storage tank and well; and (3) disconnect all water facilities of the Applicants from those of the Protestants. Both the Applicants and the Protestants would have to apply for new operating permits from VDH. Since the Applicants have only one well in operation, they presently do not qualify for an operating permit. VDH is requiring a minimum of two wells before it will issue an operating permit to the Applicants. Mr. Tufaro observed the installation of the Applicants' second well. He believes the Applicants will be able to provide adequate service in their proposed water service territory. Mr. Tufaro had occasion to view the Protestants' water system, and he believes they also have adequate facilities to meet their water needs. (Ex. MT-8, at 4-8).

[3]VDH defines an ERC as 400 gallons of water per day of usage per connection.

The Staff contacted the Abingdon field office of the VDH-Office of Water Programs. According to VDH, the facilities owned by GMPO are in good condition and the system is generally in good standing. VDH has no reason to believe that this situation would change with the proposed removal of Protestants' water facilities from the current system, assuming the Applicants' proposed improvements are made. (Ex. MT-8, at 7-8).

Mr. Tufaro confirmed that GMW&S is not proposing any change in the sewer service territory. He also confirmed that GMPO currently owns all the facilities used to provide sewer service, the use of which would be transferred to GMW&S. The Staff contacted DEQ regarding the sewer system. According to DEQ, the facilities owned by GMPO are in good condition, and the sewer system is in good standing. Mr. Tufaro believes that GMW&S will provide adequate sewer service in its proposed sewer service territory. (Ex. MT-8, at 9).

The Staff found that the Applicants' proposed quarterly water rate of $140.25 and quarterly sewer rate of $110.50 were excessive and in lieu thereof proposed rates of $128.00 and $95.00, respectively. If the Commission finds that some other rate should be appropriate, the Staff recommends that the difference in the level proposed by GMW&S be applied to the water and sewer rates on an equal percentage. (Ex. MT-8, at 10).

The Staff supports GMW&S's late payment fee of 1½ percent per month, customer deposit of two months' estimated usage, $6.00 bad check charge, $35.00 charge to terminate water service, and a $45.00 turn-on charge to restore water service. (Ex. MT-8, at 10-13).

The Staff opposes GMW&S's meter test charge and $35.00 charge to remove a meter. Since no meters are being installed, it is impossible to estimate the average cost of providing these services. (Ex. MT-8, at 12-13).

The Staff also opposed the language in GMW&S's proposed tariff that would allow the Company to change water and sewer rates through an annual assessment. The Staff found these procedures in conflict with the rate change provisions of the Small Water or Sewer Public Utility Act, specifically § 56-265.13:5 of the Code of Virginia. The Staff recommended that the Commission adopt the water and sewer rate schedules attached in Mr. Tufaro's Statement I. The Staff further recommended that GMW&S delete Rule No. 10 – Availability from its Rules and Regulations since the Company does not charge an availability fee. (Ex. MT-8, at 14).

Mr. Tufaro testified the Staff had been advised by its counsel that Protestants' issues concerning contractual matters, including requests for damages and repayment of costs, between Protestants and GMPO should be decided in another forum. In support of its position, the Staff cites *APCO v. John Stewart Walker, Inc.*, 214 Va. 524, 534, 201 S.E.2d 758, 766 (1974) (The Virginia Supreme Court held the Commission had no constitutional or statutory jurisdiction to adjudicate a common law breach of contract action.) (Ex. MT-8, at 15).

Finally, Mr. Tufaro recommended the Commission grant GMW&S certificates of public convenience and necessity to provide water and sewer service in the territories proposed in the Application. (*Id.*).

On cross-examination by Protestants' counsel, Mr. Tufaro stated the Staff has had no other case similar to this one in which an applicant proposed to split-off part of an existing water system and independently operate it. The Staff reviewed the Application as filed, including the proposed water service territory that excludes service to the Protestants' commercial complex. The Staff was aware of an understanding between the Protestants and the Applicants for the provision of water service, but noted there was never a formal contractual relationship between the parties. Generally, the Staff does not consider other territory that may be served by an applicant unless there is a contractual obligation to serve, or there are covenants or deed restrictions requiring service in that area. In determining whether the public interest is served, the Staff looks only at the customers that an applicant desires to serve in its proposed service territory. When taken as a whole, it appeared to the Staff that the Application met the public interest test. (Tr. at 72-77, 86-88, 93-94).

Mr.Tufaro explained why it was in the public interest for the Applicants to incur the cost of installing a new well, storage tank, and distribution lines rather than purchasing the Protestants' facilities. The Protestants offered to sell their storage tank and well lot to the Applicants for $100,000.00. In Mr. Tufaro's opinion, the Protestants' 30-year old water storage tank needs a complete inspection, painting inside and out, and replacement in the near future. Additionally, Mr. Tufaro believes the existing water lines need to be replaced. The lines are undersized and do not meet VDH standards. VDH recommends the installation of six-inch distribution lines, which would increase the water pressure to individual connections. Therefore, considering the age and condition of the Protestants' water storage tank and well lot, Mr. Tufaro felt such a purchase would not meet the public interest need test. (Tr. at 75-81).

Mr. Tufaro confirmed he is recommending the Commission issue GMW&S a CPCN even though it does not have the facilities in place to serve its customers. He believes GMW&S will have the ability to serve its customers. He further believes any CPCN issued to GMW&S should be conditioned upon GMW&S obtaining an operating permit from VDH for the new well and storage tank and demonstrating that it has sufficient capacity to serve its customers. Even if GMW&S were unable to timely complete the proposed improvements, this would not have an impact on the Company's CPCN. The Staff would continue to work with the Company until the improvements were completed. (Tr. at 81-85, 106-07).

On cross-examination by Applicants' counsel, Mr. Tufaro stated that on August 3, 1999, Protestants filed the initial complaint with the Commission that GMPO was operating a water company without the benefit of a CPCN. The Protestants had no complaint about the adequacy of the water or sewer service provided by GMPO. Mr. Tufaro further stated the Commission has received no complaints concerning the water or sewer service provided by GMPO. (Tr. at 95-96).

Based on the 48-hour drawdown test for the Buck Hollar Well of 14 gallons per minute and the new Dogwood Well of four gallons per minute, Mr. Tufaro believes GMW&S will have adequate capacity to serve its 112 residential customers. He also has no doubts that GMW&S will perform as it has represented in the Application. (Tr. at 99-101, 108).

In his prefiled direct, Mr. Armistead testified that GMW&S segregated its water and sewer accounts from GMPO effective January 1, 2000. In his audit of the Company's books, Mr. Armistead conducted an analysis of all test year revenue, expenses, and balance sheet accounts. He

also reviewed pro forma period costs for use in adjusting test year operations. He confirmed the Company's accounting records were maintained on an accrual basis consistent with the Uniform System of Accounts for Class "C" Water Utilities ("USOA"). (Ex. AA-9, at 2).

Mr. Armistead made 20 accounting adjustments that are reflected in his Rate of Return Statement. These included:

1. Increased revenues by $1,680.00 to reflect annualized revenues based on 112 water customers and 71 sewer customers.
2. Decreased expenses by $6,227.00 to remove charges for chemicals, repairs and supplies incurred before the test year.
3. Decreased Operations and Maintenance ("O&M") expenses by $6,165.00 to remove certain legal expenses that pertained to GMPO but were paid and booked by GMW&S.
4. Decreased O&M expenses by $3,786.00 to remove organizational expenses that should have been capitalized.
5. Increased O&M expenses by $1,797.00 to amortize over three years the cost of this proceeding.
6. Increased accounting expenses by $1,350.00 to reflect a pro forma year amount that will be considered recurring.
7. Increased O&M expense by $6,000.00 to reflect the annual salary of GMW&S's part-time secretary.
8. Increased O&M expense by $823.00 to account for liability insurance premiums that are the responsibility of GMW&S.
9. Increased O&M expense by $250.00 to reflect GMW&S's annual postage cost.
10. Increased O&M expense by $10,475.00 to include fixed or standard charges for maintenance of both the water and sewer systems.
11. Increased depreciation expense by $4,329.00 to allow a 3% composite depreciation rate.
12. Computed an annual amortization expense of $2,519.00 that GMW&S should start to book against its contributions in aid of construction ("CIAC") balance once the new plant is placed in service.
13. Increased taxes other than income taxes by $2,054.00 to annualize gross receipts and special taxes.
14. Increased utility plant in service by $9,159.00 to capitalize certain costs incurred prior to and during the test year.
15. Reduced utility plant in service by $4,879.00 to eliminate the cost of filtration equipment installed on a well not owned by GMW&S.
16. Increased utility plant in service by $3,786.00 to reclassify organizational costs from legal fees.
17. Increased construction work in progress by $8,000.00 to reclassify engineering design costs for the replacement of the water lines.
18. Increased CIAC by $83,959.00 to reclassify connection fees and contributed property that were not properly booked.

19. Increased accumulated depreciation by $27,953.00 to reflect an annualized level of accumulated depreciation on test year-end plant balances.
20. Allowed accumulated amortization of CIAC in the amount of $39,922.00.

Ex. AA-9, at 3-9.

After all the adjustments, Mr. Armistead found GMW&S's revenue requirement is $94,214.00, which produces an adjusted operating income of $18,146.00. Mr. Armistead recommends a revenue reduction of $9,890.00 and a resulting operating income of $8,471.00. Mr. Armistead believes this level of income will provide reasonable cash flow for operations. (Ex. AA-9, at 10).

Mr. Armistead recommended that the Commission order GMW&S to complete the following:

1. Apply a 3% composite rate to all depreciable plant balances and to CIAC;
2. Maintain all invoices that pertain to both expenses and capital disbursements;
3. Maintain property records on all capitalized plant items;
4. Maintain a record of all collected assessments by lot owners;
5. Restate plant, accumulated depreciation, CIAC and accumulated amortization of CIAC as of December 31, 2000, to levels reflected in Column (3) of Statement II attached to his testimony; and
6. Maintain records to enable an analysis of the costs between water and sewer.

Id.

On cross-examination, Mr. Armistead explained that he did not include the Lodge in computing his annualized revenues for GMW&S. He used only the 112 residential customers that were connected to the system at the end of 2000. The only expenses related to the separation of the water systems that Mr. Armistead could identify were the rate case expenses. Any costs for the installation of the new well and tank will be accrued as utility plant when those costs become known and certain. Mr. Armistead included the special assessments in his Rate of Return Statement as CIAC. Once the well and new tank are installed, CIAC will be reduced and utility plant in service will be increased. This also affects the amortization of CIAC and the depreciation of the new utility plant. (Tr. at 111-24).

Mr. Armistead testified the license agreement has no impact on GMW&S's ability to depreciate plant and equipment. As the operator of the utility, it gets the benefit of the depreciation of plant and equipment. (Tr. at 124-26).

On redirect, Mr. Armistead clarified that if the Lodge were going to be part of the water system, he would have had to impute revenue to GMW&S for its 20 connections, even though it had not paid for water in the past. Thus, he would have used a customer count of 132. (Tr. at 130-31).

Mr. Dalton's prefiled direct testimony addressed the Utility Transfers Act, Chapter 5 of Title 56 of the Code of Virginia, portion of the Application.[4] The Utility Transfers Act requires Commission approval of dispositions and acquisitions of utility assets by license. The Applicants are proposing that GMPO transfer by license agreement to GMW&S all of GMPO's water and sewer assets, including all real and personal property currently being used by GMPO to provide water and sewer service. GMPO will continue to own the assets; GMW&S will be granted the sole right to occupy and use the assets for a period ending on November 30, 2025. GMPO would also assign to GMW&S all its interest in any easements acquired by GMPO and required to access, repair and maintain the water or sewer systems. GMW&S will pay GMPO $100.00 for the 25-year license. Under the license agreement, GMW&S must use and operate the utility assets in compliance with all applicable federal, state, and local laws and ordinances and all regulations of federal, state, and local agencies. GMW&S is also responsible for all taxes, utilities, and maintenance of the systems. (Ex. RD-10, at 1-4).

Mr. Dalton stated the Applicants have a contract with DRAGM to operate the water and sewer systems through December 2001. If the Applicants are unable to reach an agreement with DRAGM to renew the contract, any person or entity retained by the Applicants to operate the systems would be subject to the regulations and certification requirements of VDH and DEQ. GMW&S foresees no problems in having a qualified operator under contract when the utility assets are transferred. (Ex. RD-10, at 5).

Mr. Dalton confirmed that the proposed transfer would have no impact on the rates charged for water and sewer service. If the Commission follows the Staff's recommendation, GMW&S's water rates would be reduced. (Ex. RD-10, at 5-6).

Mr. Dalton reviewed the Protestants' testimony and found that most of the issues addressed had nothing to do with the Utility Transfers Act or the Staff's review of the Application. Responding to the Protestants' claim that the Application was incomplete, Mr. Dalton stated that his questions or concerns were answered in the Applicants' responses to interrogatories. Mr. Dalton also stated he was satisfied with the reason given by the Applicants for transferring the utility assets by license rather than by sale. He stated the Staff normally does not determine whether a lease, license, or sale would necessarily be the best method of transferring a utility asset. As long as the proposed method meets the standard under the Utility Transfers Act, the Staff would recommend approval of the proposed transaction. Mr. Dalton did not review the cash assets that will be transferred since the Commission's statutory review applies only to facilities. Finally, Mr. Dalton believes the Applicants will have adequate assets to provide utility service and the statutory standard for approving the transfer of the utility assets has been met. (Ex. RD-10, at 6-8).

Mr. Dalton recommended the Commission approve the transfer of GMPO's utility assets to GMW&S pursuant to the terms of the license agreement dated December 4, 2000. He further recommended that the Commission require the Applicants to file a report with the Commission's Director of Public Utility Accounting within 30 days of the transfer notifying the Commission that such transfer has taken place. (Ex. RD-10, at 9).

[4]In order to approve a transfer of utility assets under Chapter 5 of Title 56 of the Code of Virginia, the Commission must be "satisfied that adequate service to the public at just and reasonable rates will not be impaired or jeopardized by granting the prayer of the petition." Va. Code § 56-90.

On cross-examination, Mr. Dalton testified the Staff does not look at whether the entity proposing the utility transfer has authority to make the transfer, but whether the entity has possession of the assets it is proposing to transfer by license or lease. The issue for Mr. Dalton was not lease versus license, but license versus transferring title. (Tr. at 136-37).

The Protestants offered the testimony of one witness, Allen S. Pesmen, vice president of DRP and president, treasurer, secretary and a director of DRAGM. DRP is the successor to related entities that purchased the Lodge and other real property on Groundhog Mountain in 1977 from the Small Business Administration ("SBA"), as a result of the bankruptcy of the original developer. DRP leases the Lodge to DRAGM and holds the balance of its real property for development or as an investment. DRAGM operates the Lodge commercial complex and, by management contract, has operated the utility assets owned by DRP and GMPO for the last 24 years. (Ex. AP-11, at 2-3).

When DRP acquired its Groundhog Mountain properties, they were in a state of disrepair. DRP has invested over $6 million to bring the properties up to standard. It took several years before property values on Groundhog Mountain began to stabilize and new sales began to occur. DRP has yet to show a profit on its investment in the Lodge. (Ex. AP-11, at 2-4).

Mr. Pesmen believes DRP and DRAGM have not received free water from GMPO over the last 24 years. Rather, he believes DRP and DRAGM have provided services beyond the scope of the utility management contract with GMPO. These services include: (1) year-round staffing of a general manager and maintenance personnel even though the Lodge is closed in the late fall, winter and early spring; (2) availability of maintenance personnel after hours which was beyond the compensation received in the utility management contract; (3) assumption of damages and lost income due to its inability to provide the Lodge guests access to the swimming pool; (4) maintenance of utility assets which were used in the provision of water service to GMPO; (5) use of its own wells to provide water to GMPO to replace water lost by leaks occurring off the Lodge complex; (6) forbearance in collecting summer club dues from the homeowners residing in the Groundhog Mountain developments, resulting in a loss of income over the years of approximately $500,000; and (7) other services offered residents of the Groundhog Mountain developments at no cost including snow removal, tree removal, and access to a garbage dumpster. (Ex. AP-11, at 4-5).

Mr. Pesmen testified that he contacted the Commission in mid-1999 and inquired about the licensing requirements for owners of water companies serving a large number of customers. He also inquired whether the contract operator had any obligation to pursue the licensing of such a utility and was advised that the owner, not the operator, was responsible for licensing the utility.[5] (Ex. AP-11, at 5).

According to Mr. Pesmen, the need for additional sources of water on Groundhog Mountain has been discussed as far back as 1988. At that time, GMPO asked DRAGM to investigate other sources of water; DRAGM pursued this but no decision was reached on the matter. In 1993, the decision was made to drill the Batson Cove Well, which failed within two years. In the intervening

[5] Pursuant to §§ 56-265.3 and 56-265.1 of the Code of Virginia, a company that owns or operates public utility facilities in Virginia is required to obtain a CPCN from the Commission. In which case, DRAGM would have also been responsible for obtaining a Commission-issued CPCN.

years, there have been several years of abnormally low rainfall and reports of falling water tables. As a result, there has been greater concern over water supplies. GMPO did not address these concerns until it filed the Application, at which point it drilled the Dogwood Well. Mr. Pesmen believes the costs expended in re-drilling the Dogwood Well were unwise. He is unsure of the costs to place the Batson Cove Well back into production, but believes they would be excessive for the limited production expected from the well. He believes it was GMPO's obligation to secure adequate water sources for all of its customers, including the Lodge complex. (Ex. AP-11, at 5-7).

Mr. Pesmen outlined the steps DRAGM has taken to conserve water, which included forbidding its guests from using hot tubs, restricting the use of fireplaces because of the lack of water to fight fires, and not filling its swimming pool at the beginning of the tourist season. According to Mr. Pesmen, these actions have directly impacted the Lodge's revenue. DRAGM also sent a letter, in its capacity as the utility operator, to all GMPO customers asking that they refrain from wasting water. Mr. Pesmen stated DRAGM was thoroughly rebuked by the homeowners for doing so. (Ex. AP-11, at 7).

Mr. Pesmen believes the property owners in the area, DRP, and DRAGM have been harmed by GMPO's failure to secure adequate water supplies. Some property owners have been unable to develop or resell their lots, a few property owners forfeited lots to GMPO in lieu of paying accrued assessments, several lot owners incurred the cost of drilling their own wells, and in some instances these lot owners incurred the additional costs of drilling dry wells. DRP has been unable to fully develop all of the property it owns on Groundhog Mountain and DRAGM has been unable to expand or efficiently operate the Lodge complex. Mr. Pesmen also believes DRP has been harmed by GMPO's proposal to sever the water systems. DRP has had to drill three new wells, one of which proved to be extremely successful in terms of production. DRP will incur the additional cost of the associated facilities to put the well into production and install the piping necessary to disconnect the two systems. (Ex. AP-11, at 7-9).

Mr. Pesmen explained that the failure of the negotiations between DRP and GMPO for DRP's utility assets was related to GMPO and its counsel's failure to understand the assurances DRP was seeking prior to releasing its utility assets. It was not related to the price that was to be paid for the assets.[6] (Ex. AP-11, at 9-10).

Mr. Pesmen raised several objections to the $42,500.00 GMPO assessed DRP and DRAGM for improvements to the water system. These included: (1) no master plan outlining where the money was to be used; (2) the installation of meters was not cost justified; (3) the improvements would not benefit the Protestants; (4) the assessment seeks to end-run the Commission approval process; (5) the voting process to approve the assessment was inequitable; and (6) GMPO failed to recognize the long-term capital nature of the improvements. As a result of Mr. Pesmen's objections, GMPO dropped the idea of installing meters and agreed, in settlement only, to offset the purchase price of the utility assets by the amount of the assessment. Now that GMPO has decided not to purchase DRP's utility assets, Mr. Pesmen believes GMPO is seeking to punish DRP by insisting on the collection of the outstanding assessments. (Ex. AP-11, at 10-11).

[6]DRP was seeking the sum of $100,000.00 from GMPO for its utility assets. (Tr. at 76).

Mr. Pesmen noted that several others have indicated DRP's and GMPO's water systems should be unified, including the engineering firm that has been providing services to both DRP and GMPO, and the Deer Run Villa Association. Mr. Pesmen disputes the method and manner of the vote taken by GMPO to separate the two water systems. He believes the license agreement conveniently avoids the requirement under the Articles of Incorporation, that at least two-thirds of the property owners approve a sale of the utility assets, and substitutes the will of a unique minority on the majority of property owners. (Ex. AP-11, at 12-13, 16).

Mr. Pesmen believes that a joint venture was created between DRP, DRAGM and GMPO that has established an equitable estoppel against separation of the two water systems. He further believes that, taking into consideration the improvements proposed in the Application, GMW&S would not have adequate resources to provide water service to its customers. In the past, leaks have completely drained the 55,000-gallon water storage tank. Although the Applicants are proposing to replace the water lines in the Groundhog Hills subdivision, the remainder of the system is prone to leaks and the Applicants have no funding to address these leaks. Finally, Mr. Pesmen does not believe GMW&S has the utility easements necessary to provide service. (Ex. AP-11, at 14-15).

Mr. Pesmen stated it is difficult at this time to quantify the damages and costs to DRP and DRAGM that would result from the separation of the water systems. He did cite the tremendous costs incurred to participate in this proceeding, which he attributes to GMPO's and GMW&S's defective Application. He attributes additional costs to: (1) disconnecting the two water systems; (2) putting an additional well into production to serve the Lodge; (3) crossing properties owned by other parties in order to rearrange DRP's system; and (4) incurring litigation if the Protestants decide to include the Deer Run Villas and the Tennis Chalets in its water system. (Ex. AP-11, at 16-17).

Finally, Mr. Pesmen made several recommendations for the Commission's consideration: (1) the special assessment should be nullified and refunded by GMPO; (2) the Commission should propose a new tariff that would be fair and equitable for all customers; (3) the water utilities should be prohibited from separating; (4) if the utilities are separated, the Commission should award the Protestants all their costs that have been expended, or are necessary to be expended, as a result of separation and that such costs should be assessed against GMPO and GMW&S; (5) if the utilities are separated, all written easements and other agreements should confirm the rights of Protestants to survive and establish a separate system; (6) the Protestants' legal costs and other related costs should be assessed against GMPO and GMW&S because of the substantial omissions and misrepresentations made by GMPO and GMW&S; (7) a finding should be made as to GMPO's, or GMW&S's, liability for operating a public utility for 20 years without benefit of a Commission-issued CPCN; (8) GMPO and GMW&S should be required to file a new Application incorporating the relief requested by the Protestants, and cost justify the installation of water meters; (9) if the utilities are separated, there should be a provision for an emergency interconnect; and (10) there should be a rebate, refund or credit given in the amount of the increase in assessment/tariff for the second quarter of 2001 and any subsequent quarter where the increase was based on GMPO's and GMW&S's earlier misrepresentations. (Ex. AP-11, at 18-19).

At the hearing, Mr. Pesmen vehemently denied that the Lodge was responsible for excessive water usage, as was mentioned in Mr. Viele's testimony. He attributed the excessive usage to

recurring leaks in GMPO's water system, which occur off the Lodge property. Mr. Pesmen believes the replacement of water lines should be the water company's highest priority, and he noted that with the filing of the amended Application this is now secondary to securing duplicate water sources and storage capacity. He further noted that the Applicants do not have the capital or the financing to undertake the water line replacement project. Finally, Mr. Pesmen argues that during the winter months, November through March, the Protestants were subsidizing GMPO's water system with water. Based on his calculations the Lodge complex, excluding the laundry, uses approximately 849,200 gallons of water per year, and its Doe Run Well produces approximately 974,840 gallons of water per year. Since the Lodge's laundry washes only towels, it could not use up the difference. The Lodge has a linen service that washes all the sheets, table cloths and napkins. (Tr. at 141-47; 152-156).

Mr. Pesmen also strongly disagrees with Mr. Stiffler's testimony that replacing the Protestants' 55,000-gallon water storage tank would benefit GMW&S. Mr. Pesmen believes he is the only one who has a clear understanding of the condition of the Protestants' tank. He said most of the problems with the tank occur when the tank overflows because it does not have an overflow valve. He stated the Applicants had previously indicated that they were willing to spend $30,000.00 to upgrade the tank. (Tr. at 147-48).

Mr. Pesmen believes over the years there has been a symbiotic relationship between the parties concerning water. The Lodge did not charge for the use of its water storage tank because it wanted to be a good neighbor. It wants to continue the existing relationship and have the ability to purchase water at the incremental cost to produce the water above some basic cost that allocates the fixed cost of operating the system among all the customers. (Tr. at 157-59).

In summary, Mr. Pesmen believes the Applicants, rather than spending $111,200.00 to replace the water lines in the Groundhog Hills subdivision which need to be replaced, will end up spending $205,400.00 to separate the two water systems just to spite the Protestants. (Tr. at 150-51).

Concerning GMW&S's proposed sewer service territory, Mr. Pesmen would like the Lodge complex taken out of GMW&S's territory. Mr. Pesmen finds it difficult to reconcile that the Applicants do not want to provide water service to the Lodge, yet they want to continue providing sewer service to the Lodge. (Tr. at 162-63).

Mr. Pesmen sees the license agreement as a convenient way to sidestep the requirement that 75% of the property owners approve the disposition of utility assets. The license agreement looks like a lease to Mr. Pesmen, which triggers the 75% voting requirement. Additionally, he believes the license agreement impacts the GMW&S's ability to depreciate the utility equipment. In his mind, GMW&S's customers are paying twice for equipment, once when they were assessed and again when the equipment is depreciated and the depreciation is built into the rates the customers pay. (Tr. at 164-65).

In terms of GMW&S's obligation to serve, Mr. Pesmen testified the Protestants bought their property in 1977 from the SBA. With their deed came certain rights and obligations. From 1977 to 1981, the Protestants operated the entire water system because the mortgage holder in New York

was not interested in operating a small water and sewer company in Virginia. During this period, the Protestants did not bill anyone for the service they provided. In 1981, the water system was split into two systems when Hogwild Estates deeded its utility assets to GMPO. GMPO then developed its own articles and by-laws. Mr. Pesmen believes the Applicants are superimposing their articles and by-laws on the original Declaration of Protective Covenants and Restrictions ("Protective Covenants") which established the development, and ignoring their obligation to serve. Over the years, the Protestants incurred the burden of supporting the community by maintaining a full-time presence on the mountain. In their Application, the Applicants are ignoring the Protective Covenants and the 24-year burdens incurred by the Protestants and are seeking to carve them out of the water service territory. Mr. Pesmen believes that with the mutual exchange of burdens and benefits, a quasi-contractual relationship was established between the Protestants and the Applicants. (Tr. at 166-69).

On cross-examination, Mr. Pesmen confirmed that both DRP and DRAGM are for sale. Mr. Pesmen has an agreement with his son for the sale of both entities, but that agreement is currently in default. The agreement called for sufficient financing to purchase the entities and have a limited expansion of the Lodge property. The expansion would include constructing four log cabins on the Lodge's tennis court property and dividing the ten pool chalets in half to create 20 pool chalets. (Tr. at 175-76).

As described by Mr. Pesmen, the Protestants' sewer system serves the tennis chalets, two residences, the Millpond Hideaway, and a log cabin. The Protestants' sewer system currently operates at 50% capacity. Mr. Pesmen believes it would be more economical for the Lodge complex to be served by his own sewer system. He has obtained a cost estimate to connect the Lodge to his sewer system. (Tr. at 179-84, 187).

The new well that the Protestants drilled has a certified capacity of 28-gallons per minute, but the Protestants cannot afford to put the well in service. Mr. Pesmen estimates it would take approximately $100,000.00 to place the well in service. The Protestants drilled the well to mitigate their damages caused by the unilateral separation from GMPO's water system. Mr. Pesmen believes the Protestants should supply water to the tennis chalets. He owns the majority of the tennis chalets and has obtained cost estimates to connect them to his water system. (Tr. at 185-88).

Mr. Pesmen believes the Protestants' 55,000-gallon water storage tank is approximately 30 years old. The Protestants were unable to produce any inspection reports on the tank done after January 1, 1990. About two years ago, a company offered to send divers into the tank to inspect the interior of the tank. At the time, the Protestants could not afford the $2,700.00 cost, nor could GMPO when they were told of the cost. In July 1998, GMPO requested written permission to undertake work on the tank; Mr. Pesmen did not give the required permission. Mr. Pesmen does not know whether DRAGM's manager might have given permission, but he testified he has no objection to permitting such repairs. (Tr. at 189-92).

In 1997, Mr. Pesmen had conceptual drawings made for a new 200-person conference center and a banquet facility at the Lodge. The improvements were estimated to cost $1.2 million. Additional facilities would have also been built to house some, but not all, of the people who would

attend an event at the Lodge. Mr. Pesmen has not pursued the idea of a conference center. (Tr. at 193-94, 223-27).

Based on reports submitted to VDH, it appears the Applicants' Buck Hollar Well produced approximately 4,409,000 gallons of water and the Protestants' Doe Run Well produced approximately 960,400 gallons of water during 2000. Mr. Pesmen believes it was not the Protestants' job to secure additional water sources, or expend their own funds in drilling wells. (Tr. at 201-21).

Neither the Tennis Chalet Homeowners Association nor the Doe Run Villa Homeowners Association filed any objection to the Application with the Commission, although Mr. Pesmen indicated they unofficially complained to him. (Tr. at 222).

DISCUSSION

A fight over water has disturbed the serenity on Groundhog Mountain. For over 20 years, DRAGM operated GMPO's and DRP's water facilities as one combined community water system providing water to both the part- and full-time residents living in the various Groundhog Mountain subdivisions and the Lodge commercial complex. GMPO owns its water and sewer facilities and, since 1981, has contracted with DRAGM to operate its facilities.[7] Through an informal arrangement, GMPO's and DRP's water facilities have remained interconnected during this period. This informal relationship has strained to the point that GMPO and DRP are now fundamentally at odds with each other. The reasons for the falling-out are too numerous to discuss in this Report and not germane to deciding the merits of the Application. In the Application, GMPO seeks to transfer its water and sewer facilities by a license agreement to GMW&S, a wholly owned subsidiary, which it incorporated to operate its utility facilities independently of the facilities owned by DRP and for which it seeks a Commission-issued CPCN.

[7] In 1976, Groundhog Mountain Corporation, the original developer of Groundhog Mountain, went bankrupt. Several lenders provided financing to Groundhog Mountain Corporation. It appears that the SBA provided the financing for the Lodge commercial complex, and a New York lender provided financing for the remainder of the development project. As a result of the bankruptcy, a unified water system was split into two systems. In 1976, Hogwild Estates, Inc. purchased at foreclosure sale some or all of the assets of Groundhog Mountain Corporation, including the water and sewer facilities serving the Groundhog Mountain, Doe Run, Buck Hollar, and Groundhog Hills residential developments. In 1977, DRP purchased from the SBA the Lodge and the water facilities located on the Lodge property. DRAGM, or a predecessor corporation, operated DRP's and Hogwild Estates, Inc.'s water facilities as a combined community water system because Hogwild Estates, Inc. was not interested in operating a water and sewer utility in Virginia. In 1981, Hogwild Estates, Inc. deeded its water and sewer facilities, utility easements and certain roads to GMPO. Since 1981, GMPO has contracted with DRAGM to operate its water and sewer facilities and maintain the roads throughout the development. The VDH Waterworks Operating Permit issued in July 1997, indicates that "Buck Hollar and Doe Run Lodge" were granted permission to operate a community waterworks with a designed capacity of 134 existing connections. The Lodge accounts for 20 of the 134 connections. The Protestants consider their 20 connections to be "free/exchange units" in return for use of its water facilities. The Protestants do not otherwise pay GMPO for water service. (Exs. GV-3, at 1-2; GV-1 at Exhibits 4 and 5; Tr. 166-69).

I. Accounting Issues

1. Revenue Requirement

The Protestants argue that in determining GMW&S's revenue requirement, the Staff improperly considered $199,984.00 in assessments collected by GMPO in September 1999 for water system improvements. The Protestants further argue the assessments were improperly collected and may be subject to refund if a lawsuit is filed and ultimately succeeds. Additionally, the Protestants argue GMPO has diverted the assessments from their original purpose to funding the needless separation of the two water systems. (Protestants' Post-Hearing Brief at 17).

The Staff argues its revenue requirement analysis properly included a review of all revenues, expenses, taxes, and balance sheet accounts for utility operations for the test year ending December 31, 2000. The funds GMPO collected in the special assessment were segregated for water and sewer utility operations. The Staff argues it properly relied on GMPO's records, which were maintained in accordance with the USOA, and indicated the funds were for utility service. The Staff relied on the accuracy of the records, not the propriety of the assessment, in calculating GMW&S's revenue requirement. The Staff further argues GMPO's method for determining the amount of the assessment and manner of imposing the assessment are not properly before the Commission. GMPO, not GMW&S, made the assessment. At the time of the assessment, the Commission did not regulate GMPO. Finally, the Staff argues it is improper to make accounting adjustments on the basis of potential or threatened litigation. (Staff Post-Hearing Brief at 7-8).

The Applicants argue that the 1999 assessment should be presumed valid and lawful in all respects until a court of competent jurisdiction invalidates the assessment. The Applicants further argue GMPO was not a public service corporation in 1999 and the various grounds on which the Protestants seek to challenge the assessment are not properly before the Commission. In the unlikely event a court invalidates the assessment, the Applicants argue this should have no impact on whether GMW&S should be a certificated public service company. (Applicants' Post-Hearing Brief at 2-3).

a. GMPO's 1999 Special Assessment

I agree with the Applicants and the Staff that the Commission lacks jurisdiction to review the propriety of GMPO's 1999 special assessment. The full scope of the Commission's regulatory jurisdiction over public service companies is derived from the issuance of a CPCN. GMPO was not certificated as a public service company when it made the assessment. At the time the Staff became aware of GMPO's operations, the Commission's regulatory jurisdiction was limited to enjoining GMPO's further operation of a public service company, or penalizing GMPO for operating a public service company without the benefit of a CPCN. It appears the Staff would prefer the Commission certificate GMPO, or a subsidiary, than pursue an action before the Commission to enjoin GMPO's further operation and leave its customers without water and sewer service.

b. Cash Assets from GMPO

The $199,984.00 collected by GMPO in the special assessment was segregated on its books for water and utility operations. As part of the licensing agreement, GMPO is transferring these cash assets to GMW&S. I agree with the Staff that these cash contributions from GMPO's customers should be reflected on GMW&S's books as CIAC. Such CIAC should be amortized as the associated plant is depreciated. This accounting will ensure there is no double recovery of the costs, a concern raised by the Protestants. I further agree with the Staff that it would be improper to make accounting adjustments on the basis of potential or threatened litigation. The Applicants are correct that the assessment should be presumed valid until a court of competent jurisdiction rules otherwise.

2. Rate Base

a. Accumulated Depreciation

The Staff increased GMW&S's accumulated depreciation by $27,953.00 to reflect an annualized level of accumulated depreciation on test year-end plant balances. The Applicants support the adjustment. The Protestants took no position. I find the adjustment is reasonable.

b. CIAC

The Staff increased GMW&S's CIAC by $83,959.00 to reclassify connection fees and contributed property that was not properly booked. The Applicants support the adjustment. The Protestants had no position. I find the adjustment is reasonable.

c. Amortization of CIAC

The Staff allowed GMW&S accumulated amortization of CIAC in the amount of $39,922.00. The Applicants support the adjustment. The Protestants took no position. I find the adjustment is reasonable.

II. Rules and Rate Design Issues

1. Quarterly Water and Sewage Rates

GMW&S proposed a quarterly water rate of $140.25 and sewer rate of $110.50. The Staff found that the rates were excessive and in lieu thereof proposed rates of $128.00 and $95.00, respectively. Although the Applicants did not propose a commercial rate, the Protestants argued in favor of the Commission requiring the Applicants to provide water service to the Lodge at a "reasonable rate" established by the Commission. According to the Protestants, that rate should be slightly above GMW&S's incremental cost to produce the additional water to serve the Lodge. I understood this to mean that the rate would cover only GMW&S's variable costs to run its pumps longer to supply water to the Lodge. The Protestants opposed an earlier proposal made by the Applicants to charge the Lodge an increasing block rate for water service.

Due to the Applicants' limited experience in maintaining separate books under the USOA for Class "C" Water Utilities, they are unable to dispute the recommendation of the Staff with respect to water and sewer rates. The Applicants believe the Staff's recommended rates are reasonable and endorse the Staff's recommended rates. (Applicant's Post-Hearing Brief at 4).

I agree with the Staff that its proposed $95.00 per quarter sewer rate appears reasonable.

I disagree with the Staff over its recommendation to reduce GMW&S's water rate from $140.25 to $128.00. GMW&S is a small water company with a number of problems, one of which is a deteriorating distribution system. The Applicants have proposed an ambitious three-phased plan to address GMW&S's capacity and infrastructure problems. The proceeds from the 1999 assessment appear to be sufficient to address the immediate concern of water supply capacity, which is covered in Phase I. In order to undertake Phases II and III, which address the leaks occurring in the distribution lines throughout the various subdivisions, GMW&S will need sufficient revenue or the ability to access grants or low-interest loans to pay for these improvements. If it has to borrow money to undertake the improvements, the Company will have to show the lender that it has sufficient revenues to repay the loan. I do not believe the Staff adequately considered the Company's need to fund these improvements when it made its recommendation to reduce the Company's water rates.

The Applicants intend to operate GMW&S as a non-profit water and sewer company. GMPO owns GMW&S's sole share of stock. Both GMPO's and GMW&S's Boards of Directors are made up of residents from the various Groundhog Mountain subdivisions. If GMW&S were permitted to charge a rate higher than that proposed by the Staff, I do not believe its customers face the prospect of the utility company frittering away the money. The additional revenues would be used for needed system improvements, and at some point in the future when the improvements are completed, the Company could come back before the Commission and request a rate decrease. It should be noted that none of the customers GMW&S intends to serve complained about the Company's proposed water or sewer rates.

Given GMW&S's limited financial operating history, its ambitious infrastructure improvement plan, and its intention to operate as a non-profit water and sewer company, I would err on the side of caution and permit GMW&S to charge the $140.25 per quarter water rate it has requested. If GMW&S must pursue bank financing to make improvements to its distribution system, this eliminates the need for the Company to incur the time and expense associated with coming before the Commission at some later date to request a rate increase to fund the improvements. If the Commission approves the water rate recommended herein, GMW&S should be required to escrow the difference between the $110.50 recommended by the Staff and the $140.25 recommended herein as CIAC. The use of such CIAC should be limited to future water system improvements. The escrow account should be effective upon the issuance of the Commission's Final Order in this case. This accounting will ensure that the Company's ratepayers do not pay for the improvements twice. [8]

[8] Section 56-265.13:43 of the Code of Virginia contemplates that reasonable and just charges for service shall include funds necessary for making system replacements.

A revised Rate of Return Statement and Revenue Calculation are attached to this Report as Hearing Examiner Statement II and Hearing Examiner Appendix A, Page 1. Water service to the Protestants will be addressed later in this Report.

2. Late Payment Charge

GMW&S proposed a 1½ percent per month late payment fee. The Staff supported this charge. The Protestants took no position. I find GMW&S's proposed late payment fee of 1½ percent per month is reasonable.

3. Customer Deposit

GMW&S proposed a customer deposit of two months' estimated usage. The Staff supported GMW&S's proposed customer deposit. The Protestants had no position. I find GMW&S's proposed customer deposit of two months' estimated usage is reasonable.

4. Bad Check Charge

GMW&S proposed a bad check charge of $6.00. The Staff supported this charge. The Protestants took no position. I find GMW&S's proposed bad check charge of $6.00 is reasonable.

5. Meter Test/Meter Removal Charges

GMW&S proposed a $35.00 charge to test a meter unless the meter is found to have an average error greater than two percent. GMW&S also proposed to charge $35.00 to remove any meter at the customer's premises. The Staff opposed GMW&S's meter test and meter removal charges. The Staff found it impossible to estimate an average cost of providing these services since GMW&S is not proposing to install meters. The Protestants opposed the installation of water meters as an unnecessary expense. The Applicants have no objection to removing the meter test and meter removal charges from GMW&S's tariff. Since GMW&S has no current plans to install water meters, I find that the meter test and meter removal charges in GMW&S's tariff would lead to customer confusion; therefore, such charges should be deleted from the tariff.

6. Water/Sewer Termination Charge

GMW&S proposed a $35.00 charge to terminate water and/or sewer service for non-payment of any utility bill, for a violation of the Company's rules and regulations of service, or for termination of water service at the customer's request. The Staff supported this charge. The Protestants had no position. I find GMW&S's proposed $35.00 water/sewer termination charge is reasonable. It appears from the record that the charge is less than the actual cost of performing the service.

7. Water Turn-On Charge

GMW&S proposed a $45.00 charge to restore water service if such service has been discontinued for violation of the Company's rules and regulations of service or for non-payment of

any bill. The Staff supported this charge. The Protestants took no position. I find GMW&S's proposed $45.00 water turn-on charge is reasonable. It appears from the record that the charge is less than the actual cost of performing the service.

8. Tariff Language

The Staff opposed the language in GMW&S's proposed tariff that would allow the Company to change its water and sewer rates through an annual assessment.[9] The Staff found this language conflicts with the rate change provisions in § 56-265.13:5 of the Code of Virginia. The Staff recommended that the Commission adopt the water and sewer rate schedules attached to Mr. Tufaro's Statement I. The Protestants had no position. The Applicants agreed that the language contained in Mr. Tufaro's Statement I should be used in lieu of the proposed tariff language. I find that GMW&S's proposed water and sewer rate tariff language conflicts with § 56-265.13:5 of the Code of Virginia. I recommend the Commission require GMW&S to use the language found in Mr. Tufaro's Statement I.

The Staff also recommended that GMW&S delete Rule No. 10 – Availability from its rules and regulations since the Company does not charge an availability fee. The Protestants had no position. The Applicants agreed that the rule should be deleted. I find that Rule No. 10 – Availability should be deleted from GMW&S's tariff. Since the Company does not charge an availability fee, this will eliminate a source of potential confusion for the Company's customers.

9. Water and Sewer Service Territories

The Applicants propose to serve 54 single-family residences, 24 Deer Run Villa condominiums, and 34 tennis chalet condominiums located in the Groundhog Mountain, Doe Run, Buck Hollar and Groundhog Hills subdivisions. The Applicants do not wish to serve the Lodge commercial complex, which consists of a restaurant, ten pool chalets available for rent, a swimming pool, and a laundry facility. The Applicants believe GMW&S has sufficient water capacity and will have sufficient facilities to serve the customers it intends to serve in its proposed service territory. (Applicants' Post-Hearing Brief at 6, 8).

In their Post-Hearing Brief, the Applicants noted that they have no legal interest in the Protestants' water facilities, which consist of one well, a 55,000-gallon storage tank, a 5,000-gallon hydro-pneumatic storage tank, pumps and related equipment, water treatment facilities, and water lines. They further noted there is no written agreement between the parties regarding the relationship between the two water systems. The Applicants state they have no legal interest in Protestants' water facilities and no legal right to use the facilities. The Applicants further state the Protestants' argument that the Lodge complex should be included in GMW&S's service territory must be examined in the context of the Applicants' ability to serve their residential customers and the Lodge commercial complex with their existing water facilities. As defined by the Applicants, the issue is whether GMPO's two wells and proposed 30,000-gallon storage tank are adequate to serve the 112 residential customers and the Lodge. The Applicants argue the Protestants resolved this issue when Mr. Pesmen testified the Applicants would not have adequate water resources to

[9] *See* infra, Report pp. 1-2.

serve their residential customers and the Lodge. The Applicants argue stretching inadequate resources even further to serve the Lodge would not serve the public interest. (*Id.* at 6-7).

The Applicants further argue the Protestants will not be harmed if GMW&S does not serve the Lodge. The Applicants noted Mr. Pesmen's testimony that for calendar year 2000 the Lodge consumed 849,200 gallons of water. The Lodge's Doe Run Well met this demand by producing 947,840 gallons of water in 2000, and has met the Lodge's water needs on an annual basis. The Applicants noted that the Lodge has the advantage of a new well that produces water at four times the rate of its Doe Run Well. The Applicants argue the Protestants should be able to place their new well in operation for around the same cost, $69,000.00, that the Applicants expended to place the Dogwood Well in operation. The Applicants consider this sum modest when compared to the $6 million the Protestants have invested in the Lodge. (*Id.* at 7-8).

Finally, the Applicants argue the interests of the residential customers and the Lodge are inherently incompatible. In response to the Protestants' argument in favor of a discount for high volume water users, the Applicants argued GMW&S's rate structure may require higher rates for higher volume users in order to create a disincentive to abuse the limited water resources on Groundhog Mountain. Although it has no current plans to install water meters, GMW&S may have to install meters in the future to promote fairness in billing. The Protestants are opposed to the installation of water meters. The Applicants also cited differences in priorities to expend funds for water system improvements. The Applicants cited the Protestants' refusal to pay water assessments because the replacement of residential water lines would not benefit the Lodge. The Applicants believe a requirement to serve the Lodge would be akin to a shotgun wedding and would serve only to promote continued strife on Groundhog Mountain. (*Id.* at 10-11).

In its Post-Hearing Brief, the Staff took no position on the issue raised at the hearing that the original developer's Protective Covenants or property deeds created a pre-existing obligation for GMW&S to provide water service to the Lodge. The Staff noted there is insufficient evidence in the record for the Commission to make such a determination. The Protestants submitted no documents into evidence to support their claim. The Staff believes the pertinent issue is not any pre-existing right of the Protestants to receive water service, but rather, whether such service should continue. (Staff Post-Hearing Brief at 11-12).

The Staff further argued the Commission has authority, pursuant to § 56-265.1(b)(1) of the Code of Virginia to grant a utility permission to discontinue providing water service to its customers. Since the Protestants identified properties outside the Applicants' proposed service territory that formerly received water service and raised the question whether such service should continue, the Staff believes an abandonment analysis may be appropriate in this proceeding and evidence in the record is sufficient to support such an analysis. (Staff Post-Hearing Brief at 13-18).

Finally, the Staff argues the Protestants' reliance that there is legislative intent expressed in §§ 56-265.1(b)(1) and 56-265.3 of the Code of Virginia to maintain the status quo with respect to utility service is misplaced. The Staff believes these statutes are not applicable in this proceeding. (Staff Post-Hearing Brief at 13-18).

The Protestants argue the Applicants have a legal obligation to continue to provide water service to the Lodge. The Protestants believe their position is supported by the Code of Virginia and established principles of common law. In support of their position, the Protestants cite § 56-234 of the Code of Virginia, which provides that "[i]t shall be the duty of every public utility to furnish reasonably adequate service and facilities at reasonable and just rates to any person, firm or corporation along its lines desiring same." The Protestants argue Chapter 10 and Chapter 10.1 of Title 56 apply equally to the Applicants. To hold otherwise would leave the Lodge without reasonably adequate water service. The Protestants also rely on § 56-265.1(b)(1) of the Code of Virginia, which provides that a public utility "shall not abandon the water or sewer services unless and until approval is granted by the Commission. . . ." The Protestants argue the Commission presumably would not approve an abandonment unless it could be shown that the customers will not be harmed by the abandonment. There should be some proof that the Protestants will be served by another public utility. (Protestants' Post-Hearing Brief at 6-9).

The Protestants also argue the common law principle of implied easement by pre-existing use, or quasi-easement, applies in this case. They argue a court will find an implied easement by pre-existing use where dominant and subservient tracts of land originated from a common grantor. The Protestants argue if a use of the land was in existence at the time of severance and the use is apparent, continuous, and reasonably necessary for the enjoyment of the dominant tract, then a court will find an implied easement exists.[10] The Protestants applied the test in this case and found: (1) the "common grantor" is analogous to the common use of water; (2) the proposed separation of the water systems is analogous to partitioning a common parcel; and (3) the common use of water was in existence at the time of severance, the use has been continuous for over 20 years, and the use is necessary to the enjoyment of the Lodge. The Protestants argue they should be granted a "quasi-easement" allowing the Protestants the continued right to access water supplied by GMW&S. (Protestants' Post-Hearing Brief at 9-10).

Finally, the Protestants argue the Commission can issue a CPCN only if it "finds such action in the public interest." Section 56-265.3 B of the Code of Virginia. The Protestants define the "public" as the current customers and any proposed customers, and argue separation of the water systems is not in best interests of those customers. The Protestants believe the separation costs incurred by the Applicants, and proposed to be incurred, would be unnecessary had the Applicants included the Lodge in its proposed service territory. The Protestants estimate it will take approximately $205,000.00 to separate the two systems and believe this amount could have been better spent repairing the Groundhog Hills water lines. The Protestants believe the various reasons cited by the Applicants for separating the water systems are a weak attempt to rationalize excluding the Protestants because of personal animosity. (Protestants' Post-Hearing Brief at 10-14).

[10] *See*, *Russakoff v. Scruggs*, 241 Va. 135, 141, 400 S.E.2d 529, 533 (1991) (residential owners enjoyed easement in man-made lake created by subdivision developers); *Stoney Creek Resort, Inc. v. Newman*, 240 Va. 461, 466, 397 S.E.2d 878, 881 (1990) (landowners found to have implied easement in lake and recreational facilities where parties to land transaction contemplated that purchasers would have access to water for recreational purposes, where access to water added materially to value of property, and use of water was reasonably necessary for the beneficial use and enjoyment of property conveyed.).

a. Requirement to Serve The Doe Run Lodge Commercial Complex

The Commission cannot officiate over shotgun weddings. Likewise, the Commission cannot require a public utility to provide service using facilities that it does not own or control, nor can it require a public utility to purchase facilities to serve a customer outside its proposed service territory. This is precisely the outcome the Protestants desire in this case. Having failed to reach an agreement on the sale of their utility facilities, the Protestants now seek to have the Commission impose such a sale by requiring the Applicants to provide water service to the Lodge. I agree with the Applicants that their Application must be evaluated in the context of GMW&S's ability to provide water service in its proposed service territory using its own facilities. The Applicants have no legal right to use the Protestants' water facilities and such right was not granted in this case. In the absence of such an agreement, I find the Applicants properly excluded the Protestants from their proposed service territory. The Applicants do not own or control the water facilities necessary to provide water service to the Protestants. Additionally, while it may appear that the Applicants may have sufficient water resources to serve the Protestants, the Applicants do not have sufficient water storage capacity. The Applicants will have a 30,000 gallon storage tank, which is sufficient to serve only their proposed residential customers.

I disagree with the Staff and the Protestants that an abandonment analysis applies in this case. In terms of abandoning physical facilities, the Applicants never owned or controlled the utility facilities located on the Protestants' property. Therefore, the Applicants are abandoning no facilities. In terms of abandoning a "customer," there is no evidence in the record that the Lodge was ever, in fact, a water utility "customer" of GMPO. In ordinary usage, a customer is "one that buys goods or services." The American Heritage College Dictionary 341 (3d. ed. 1997). There is no evidence in the record that the Lodge ever purchased water from GMPO, or that a business-customer relationship existed between GMPO and the Lodge. They may have been joint venturers, quasi-partners, or parties to an informal arrangement in providing community water service on Groundhog Mountain, but GMPO and the Lodge were not involved in a business-customer relationship. In the absence of such evidence, I cannot find that the Applicants are abandoning a water utility "customer."

The Protestants argue they should be granted an implied easement by pre-existing use, or quasi-easement, to continue accessing water supplied by GMW&S. I cannot find that an implied easement by pre-existing use, or quasi-easement, exists in this case. An implied easement is based on the legal principle that when land is conveyed all that is necessary for the use and enjoyment of the land is conveyed at the same time. *Russakoff v. Scruggs*, 241 Va. 135, 138-39, 400 S.E.2d. 529, 532 (1991). When the SBA conveyed the Lodge commercial complex to the Protestants, it also conveyed a 55,000-gallon water storage tank, a 5,000-gallon hydro-pneumatic water storage tank, one well, pumps and related equipment, and water lines. The evidence in the record indicates that these facilities are more than adequate to meet the Protestants' water needs. If anyone in this case has an argument for an implied easement by pre-existing use it would be GMPO and its homeowner members. At the time it received its water facilities from Hogwild Estates, Inc., GMPO was and still is, dependent upon the Lodge's water storage capacity. The Applicants, however, have plans to construct a 30,000-gallon water storage tank for GMW&S's use, which when placed in service would eliminate the need to store water in the Protestants' 55,000 gallon tank.

There is insufficient evidence in the record to make a finding on whether the original developer's Protective Covenants or the property deeds created an obligation on the part of the Applicants to provide water service to the Lodge. The Protective Covenants and the property deeds were not submitted into evidence.

b. Harm to the Protestants; Financial Hardship/Inadequate Water Supply

The Protestants had the evidentiary burden of establishing they would be harmed by being excluded from GMW&S service territory. The Protestants failed to meet their evidentiary burden. The evidence in the record indicates the Protestants have sufficient water resources and facilities to meet their own water needs, and will not need to build any additional facilities to meet their own water needs. For calendar year 2000, the Protestants' water facilities produced 947,840 gallons of water and the Protestants consumed 849,200 gallons, a surplus of 98,640 gallons or more than one month's expected usage. The evidence further indicates the Protestants have met their water needs using their own water facilities every year for the past 20 years. Mr. Pesmen was quite adamant in his testimony that the Protestants have never received any free water from GMPO. Since the Applicants are proposing to disconnect their system from that of the Protestants, the Applicants will have to bear the cost of physically disconnecting the two systems. Based on the foregoing, I find the Protestants will suffer no financial hardship or lack of water supply from being excluded from GMW&S's service territory.

c. Proposed Service Territory in the Public Interest

I agree with the Applicants that the public interest will be served by separating GMPO's and the Lodge's water systems. The two systems should have been either separated or combined into one system in 1981 when Hogwild Estates, Inc. deeded its water system to GMPO. Instead, DRAGM continued to operate the two water systems as one community water system as it had in the past. The failure to formalize the relationship between the two systems is the primary factor for the hard feelings that currently exist on Groundhog Mountain. There is a time in many relationships when a divorce becomes necessary. This is especially true when there are irreconcilable differences between the parties. Those differences exist in this case, especially as it concerns rates and terms of service. GMPO wanted the Lodge to pay an increasing block rate for water service and the Lodge wanted to pay only the incremental cost to produce additional water to meet its needs. One cannot imagine more diametrically opposed positions. As previously stated, the Protestants have sufficient water resources and facilities to meet their own water needs, so they will not be prejudiced by being excluded from GMW&S's service territory. Conversely, by formally separating the two systems, GMPO's homeowner members gain complete direction and control over their water system. I find GMW&S's proposed water service territory to be in the public interest.

III. Chapter 5 Transfer Issues

The Applicants argue that using a license agreement to transfer utility assets is specifically authorized by the Utility Transfers Act.[11] In this case, the Applicants are proposing to transfer not only GMPO's utility assets, but also the utility easements and the proceeds from the special assessment. The Applicants argue the sole issue for the Commission to decide under the Act is

[11] *See*, § 56-88 of the Code of Virginia.

whether "adequate service to the public at just and reasonable rates will not be impaired or jeopardized."[12] Citing the Staff's testimony, the Applicants argue the standard has been met in this proceeding. (Applicants' Post-Hearing Brief at 11-12).

In response to the Protestants' argument that a "proper vote" was not taken to approve the transfer of the assets by GMPO, the Applicants rely on *Appalachian Power Company v. Walker*, 214 Va. 524, 531, 201 S.E.2d 758, 764 (1974) where the Virginia Supreme Court found ". . . Commission jurisdiction turns upon the existence of a public duty imposed by law upon public service corporations." (Emphasis in original). The Applicants argue GMPO was not and will not be a public service corporation. Therefore, corporate governance issues, including voting rights and parliamentary procedure, are beyond the Commission's jurisdiction. As a further argument, the Applicants state there is no record before the Commission to examine such issue. (Applicants' Post-Hearing Brief at 12-13).

The Staff argues it evaluated the proposed transfer as required by § 56-90 of the Code of Virginia and found the transfer met the requirements of the statute. The Staff did not evaluate the method of transfer, but considered the transfer as presented in the Application as it would affect customers' rates and service. (Staff Post-Hearing Brief at 20-21).

The Protestants argue the license agreement transferring the utility assets is really a lease agreement and GMPO cannot subvert its Articles of Incorporation, and the voting requirements in its Articles, by calling a lease a license. The Protestants argue the agreement conveys to GMW&S ". . . the sole right to occupy and use all real property of which Licensor is the fee simple owner on the date of this License Agreement and used by Licensor in connection with Licensor's operation and maintenance of water or sewer systems. . . ." The Agreement further provides that "real property" includes: "[a]ll of Licensor's right, title and interest to the tracts or parcels of land with improvements thereon or appurtenances and easements. . . ." The Protestants argue it is a well-established principle of property law that a grant, which creates any interest or estate in land, is not a license.[13] The Protestants argue the "License Agreement" is really a Lease Agreement" and GMPO cannot transfer utility assets by lease until two-thirds of its membership approves the transfer. Such approval has not been obtained in this case, therefore, the Commission cannot approve the transfer until a proper vote is taken. (Protestants' Post-Hearing Brief at 18-19).

1. Transfer by License Agreement

Section 56-90 of the Code of Virginia provides, in part, that: [i]f and when the Commission, with or without hearing, shall be satisfied that adequate service to the public at just and reasonable rates will not be impaired or jeopardized by granting the prayer of the petition [to acquire or dispose of utility assets], the Commission shall make such order in the premises as it may deem proper and the circumstances require, and thereupon it shall be lawful to do the things provided for in such

[12] *See*, § 56-90 of the Code of Virginia.

[13] *See*, 12A Michie's Jurisprudence License to Real Property §2; *Church v. Goshen Iron Co.*, 112 Va. 694, 697, 72 S.E. 685, 686 (1911) ("In order to ascertain whether an instrument must be construed as a lease or a license, it is only necessary to determine whether the grantee has acquired by it any estate in the land, in respect of which he might bring an action of ejectment. If the land is still to be considered in the possession of the grantor, the instrument will only amount to a license.").

order. . . ." (Emphasis added). Section 56-88 defines "acquire" to include: "any purchase or other acquisition, whether by payment, exchange, gift, conveyance, lease, license, merger, consolidation or otherwise."

For purposes of the Commission's review of the Application, it is irrelevant whether the agreement transferring the utility assets is a license or a lease; both are expressly accepted methods for transferring utility assets under the Utility Transfers Act. If the Protestants object to the form of the agreement, that issue should be decided in a court of competent jurisdiction. The Commission's jurisdiction is limited to determining whether "adequate service to the public at just and reasonable rates will not be impaired or jeopardized" by the transfer of the utility assets.

2. Adequate Service to the Public at Just and Reasonable Rates

I find that "adequate service to the public at just and reasonable rates will not be impaired or jeopardized" by the transfer of the water and sewer utility assets from GMPO to GMW&S. After the transfer, GMW&S will have adequate water resources. It will have the Buck Hollar Well which produces at the rate of 17-18 gallons per minute, the Dogwood Well which produces at the rate of four gallons per minute, and if needed, it could place the Batson Cove Well back into production. GMW&S will also have adequate water storage facilities when its new 30,000-gallon water storage tank is placed in service. GMW&S also plans to upgrade the waterlines in the Groundhog Hill subdivision, where most of the leaks have occurred in the past. The sewer facilities are currently under-utilized. The water and sewer rates recommended herein are just and reasonable. Once certificated, GMW&S's future requests for increases in its water or sewer rates would be subject to Commission review.

IV. Protestants' Issues

1. Alternative Relief

a. Modified Water Service Territory

If the Commission excludes the Lodge commercial complex from GMW&S's water service territory, the Protestants argue the Tennis Chalets and Deer Run Villas condominiums should have the right to elect to be excluded from GMW&S's service territory and included in the Protestants' territory. (Protestants' Post-Hearing Brief at 20).

The Applicants argue the Protestants would need a CPCN to provide water service to the Tennis Chalets and Deer Run Villas condominiums and the Protestants have filed no application. Consequently, the Commission has no information whether the Protestants have the financial, managerial, or technical ability to provide safe and reliable water service at just and reasonable rates. On the other hand, the Staff has reviewed GMW&S's ability to provide water service in its proposed service territory, and found that GMW&S has the ability to provide such service. The Applicants argue to reserve service territory for the Protestants under these circumstances would not be in the public interest. (Applicants' Post-Hearing Brief at 20-21).

The Applicants further argue Protestants' request ignores the fact that neither the Tennis Chalets nor the Deer Run Villas Homeowners Associations have requested water service from the Protestants. The Applicants argue there is no public dissatisfaction with the Applicants' water service, and the Commission should not assume there is any public support for the Protestants to provide water service. Finally, the Applicants argue under no circumstances should homeowners be involuntarily subjected to water service from an unregulated for-profit corporation. (Applicants' Post-Hearing Brief at 21-22).

I find the Protestants' request for a modified water service territory should be denied. The Protestants have not filed a competing application to serve some or all of the same water service territory requested by the Applicants. Consequently, there is no evidence in the record upon which the Commission could base an award of the requested service territory to the Protestants.

b. Modified Sewer Service Territory

If the Commission excludes the Lodge commercial complex from GMW&S's water service territory, the Protestants argue the Commission should use its discretion and determine that the Lodge commercial facility should be served by the same utility for both water and sewer. The Protestants request that the Lodge commercial facility be removed from GMW&S's sewer service territory. (Protestants' Post-Hearing Brief at 20).

The Applicants argue the Protestants' proposal is illogical because the Applicants have applied for two CPCNs for separate and distinct utilities, each with its own service area. The Applicants believe there is no linkage between the water and sewer service territories. They further believe the Protestants' request is not in the public interest and is simply based on Protestants' personal preference. The Applicants state there are two sewer utilities on Groundhog Mountain, each with its own geographically defined service territory. On one side of the ridge, GMPO has served approximately 46 single-family residences, 24 Deer Run Villas and the Lodge commercial complex. On the other side of the ridge, the Protestants have served the 34 Tennis Chalets and several other properties owned by the Protestants. There have been no complaints concerning GMPO's sewer service and each sewer utility would continue to serve its existing customers. (Applicants' Post-Hearing Brief at 22-23).

The Applicants further argue that, given the Lodge's location at the top of the ridge, it could theoretically be served by either utility. The public interest would be served if GMPO continued to serve the Lodge. GMPO's sewer facility is currently operating at 25% capacity and it needs the Lodge's effluent for purposes of operating efficiency. Unlike the water system, GMPO's sewage treatment plant has sufficient capacity to serve the Lodge commercial complex, even if it expanded to serve a 200-person conference center.

I find the Protestants' request for a modified sewer service territory should be denied. I agree with the Applicants that the public interest would be served by maintaining the existing sewer service territories. The Applicants' sewer system needs the Lodge's effluent in order to maintain its operating efficiency. If the Lodge's sewer discharges into the plant are removed, an environmental problem may be created as inefficiently treated sewage is discharged into the tributary of Bird's Branch. Given this uncertainty, the sewer service territories should remain unchanged.

c. Other Relief

The Protestants made a number of other recommendations for the Commission's consideration.[14] Several of the recommendations have been resolved elsewhere in the Report. The remaining recommendations deal with monetary damages, costs and attorney fees, utility easements, penalties and an emergency interconnection. The Commission does not have jurisdiction to award monetary damages or the Protestants' costs or attorney fees incurred in this proceeding. At present, there is no case in controversy involving any request for the Protestants to cross any of the Applicants' utility easements. If such controversy arises, the Protestants may file a petition and be heard by the Commission. Although GMPO has been operating for over 20 years without a Commission-issued CPCN, I do not believe any penalties are appropriate in this proceeding. The present case is an application proceeding, not a rule to show cause proceeding. The very nature of this proceeding precludes the imposition of any penalties. Finally, the Commission should not require an emergency interconnection between the Applicants' and Protestants' water systems. There is no provision in the Applicants' proposed tariff for such interconnection and no agreement as to the cost for water supplied to either party through such interconnection.

V. Other Issues

1. GMW&S Certificate of Public Convenience and Necessity

The Applicants argue the record supports the issuance of a CPCN to GMW&S. The Applicants noted the Staff's testimony that: (1) GMW&S will have the facilities to provide adequate water and sewer service to its customers; (2) GMW&S will provide adequate water and sewer service to its customers at reasonable rates; and (3) GMW&S's books are maintained in accordance with the USOC for Class "C" Water Utilities. The only complaint received by the Commission relating to the water and sewer utility concerned the lack of a CPCN, not the quality of water or sewer service provided. GMPO's president believes GMW&S will be able to provide safe and reliable water and sewer service to GMPO's membership at reasonable cost. The water system is in good standing with the VDH and the sewer system is in good standing with DEQ. Although the Protestants are challenging GMW&S's water resources, the Protestants offered no expert testimony that GMW&S will have inadequate capacity to serve the customers it proposes to serve. Finally, GMW&S's customers will benefit by virtue of receiving water and sewer service that is subject to Commission oversight. (Applicant's Post-Hearing Brief at 24-25).

The Staff cites § 56-265.3 of the Code of Virginia, which provides that the Commission "may, by issuance of a certificate of public convenience and necessity, allot territory for development of public utility service by the applicant if the Commission finds such action in the public interest." Based on its review and investigation of the Application, the Staff recommended that the Commission grant GMW&S a CPCN. The Staff believes the basic criteria for determining whether the granting of a CPCN is in the public interest, the ability of the utility to provide adequate service under all the circumstances there and then prevailing, is satisfied in this case.[15] The Staff also believes the record supports a finding that GMW&S is able to provide adequate water and

[14] *See infra*, Report Page 18.
[15] *See, Virginia Gas Distribution Corp. v. Washington Gas Light Co.*, 201 Va. 370, 377-78 (1959).

sewer services in its proposed service territories. Finally, GMW&S's rates, as revised by the Staff, appear just and reasonable. (Staff Post-Hearing Brief at 21-24).

The Protestants do not oppose the issuance of a CPCN to GMW&S. If such certificate is issued, the Protestants request that the Commission include the Lodge commercial complex in GMW&S's water service territory. If the Commission issues a certificate to GMW&S that excludes the Lodge commercial complex from GMW&S's water service territory, the Protestants request that the Lodge commercial complex be excluded from GMW&S's sewer service territory and that the Commission remove the Tennis Chalets and Doe Run Villa condominiums from GMW&S's water service territory. (Protestants' Post-Hearing Brief at 2-3, 20).

The record indicates that GMW&S has adequate water capacity, it will have adequate facilities in place to serve the customers it intends to serve in its proposed service area, and it will have adequate financial resources to undertake at least the improvements contemplated in Phase I of its water system improvement program. As set forth herein, GMW&S's water rate of $140.25 per quarter appears reasonable given the system improvements contemplated in Phases II and III of its water system improvement program. Additionally, GMW&S's revised sewer rate of $95.00 per quarter appears reasonable. Considering the foregoing, I find GMW&S has the ability to provide adequate water and sewer service at just and reasonable rates in its proposed service territories.

FINDINGS AND RECOMMENDATIONS

Based on the evidence received in this case, and for the reasons set forth above I find that:

(1) The Commission lacks jurisdiction to review the propriety of GMPO's 1999 special assessment;

(2) The proceeds from GMPO's 1999 special assessment should be reflected on GMW&S's books as a cash contribution in aid of construction and the amortization of such CIAC should commence when associated plant is placed in service and depreciated;

(3) The Staff's $27,953.00 increase in GMW&S's accumulated depreciation to reflect an annualized level of accumulated depreciation on test year-end plant balances is reasonable;

(4) The Staff's $83,959.00 increase in GMW&S's contributions in aid of construction to reclassify connection fees and contributed property that was not properly booked is reasonable;

(5) The Staff's $39,922.00 allowance for GMW&S of accumulated amortization of contributions in aid of construction is reasonable;

(6) The Staff's proposed $95.00 per quarter sewer rate for GMW&S is reasonable;

(7) The Commission should set GMW&S's water rate at $140.25 per quarter and such rate is reasonable given the circumstances of this case;

(8) The Commission should required GMW&S to escrow the difference between the $110.50 recommended by the Staff and the $140.25 recommended herein as CIAC. The use of such CIAC should be limited to future water system improvements;

(9) GMW&S's proposed late payment fee of 1½ percent per month is reasonable;

(10) GMW&S's proposed customer deposit of two months' estimated usage is reasonable;

(11) GMW&S's proposed $6.00 bad check charge is reasonable;

(12) GMW&S's proposed meter test and removal charges should be deleted from its Tariff;

(13) GMW&S's proposed $35.00 water/sewer termination charge is reasonable;

(14) GMW&S's proposed $45.00 water turn-on charge is reasonable;

(15) GMW&S's proposed water and sewer rate tariff language conflicts with § 56-265.13:5 of the Code of Virginia, and in lieu thereof the Commission should require GMW&S to substitute the language found in Mr. Tufaro's Statement I;

(16) Rule No. 10 – Availability should be deleted from GMW&S's tariff;

(17) There is no statutory, common law or contractual duty requiring GMW&S to include the Lodge commercial complex in its water service territory;

(18) The evidence indicates Protestants will suffer no financial harm, or be faced with an inadequate water supply, by being excluded from GMW&S's water service territory;

(19) GMW&S's proposed water service territory is in the public interest;

(20) Pursuant to § 56-265.3 of the Code of Virginia, the Commission should issue a certificate of public convenience and necessity to GMW&S to provide water service in the territory requested in its Application. The certificate of public convenience and necessity should be conditioned upon GMW&S receiving an operating permit from VDH for its new well and storage tank;

(21) GMW&S's proposed sewer service territory is in the public interest;

(22) Pursuant to § 56-265.3 of the Code of Virginia, the Commission should issue a certificate of public convenience and necessity to GMW&S to provide sewer service in the territory requested in its Application;

(23) The Commission should require GMW&S to apply a 3% composite rate to all depreciable plant balances and to CIAC;

(24) The Commission should require GMW&S to maintain all invoices that pertain to both expenses and capital disbursements;

(25) The Commission should require GMW&S to maintain property records on all capitalized plant items;

(26) The Commission should require GMW&S to maintain a record of all collected assessments by lot owners;

(27) The Commission should require GMW&S to restate plant, accumulated depreciation, CIAC and accumulated amortization of CIAC as of December 31, 2000, to levels reflected in Column (3) of Statement II attached to Mr. Armistead's prefiled testimony;

(28) The Commission should require GMW&S to maintain its records in a manner to enable an analysis of the costs between its water and sewer operations;

(29) It is irrelevant whether the agreement transferring the water and sewer utility assets is a license or a lease; both are expressly accepted methods for transferring utility assets under the Utility Transfers Act;

(30) Adequate service to the public at just and reasonable rates will not be impaired or jeopardized by the transfer of the water and sewer utility assets from GMPO to GMW&S;

(31) Pursuant to the Utility Transfers Act, the Commission should approve the transfer of water and sewer utility assets from GMPO to GMW&S;

(32) Pursuant to § 56-265.2 of the Code of Virginia, the Commission should issue GMW&S a certificate of public convenience and necessity to acquire the water and sewer utility facilities from GMPO;

(33) The Commission should require the Applicants to file a report with the Commission's Director of Public Utility Accounting within 30 days after the transfer of the utility assets from GMPO to GMW&S notifying the Commission that such transfer has taken place;

(34) The Protestants' request to modify GMW&S's water service territory should be denied;

(35) The Protestants' request to modify GMW&S's sewer service territory should be denied; and

(36) The Protestants' various requests for other relief should be denied.

I therefore ***RECOMMEND*** the Commission enter an order that:

(1) ***ADOPTS*** the findings contained in this Report;

(2) ***APPROVES*** the transfer of utility assets from GMPO to GMW&S pursuant to the terms of the license agreement dated December 4, 2000;

(3) ***GRANTS*** GMW&S a certificate of public convenience and necessity to operate a water utility in the service territory it has requested;

(4) ***GRANTS*** GMW&S a certificate of public convenience and necessity to operate a sewer utility in the service territory it has requested; and

(5) ***PASSES*** the papers herein to the file for ended causes.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and 5 VAC 5-20-120 C) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within twenty-one (21) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

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Michael D. Thomas
Hearing Examiner